

EMU: how it works (and which parts don't apply to us)

LSE blogs.lse.ac.uk/brexit/2016/01/18/between-the-european-economic-and-monetary-union-and-banking-union-there-is-a-fairly-stable-relationship-among-the-euro-ins-and-the-euro-outs/

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Following the proceedings of the [first session](#) of the [LSE Commission on the Future of Britain in Europe](#), we continue the topic of parity between the Euro-ins and the Euro-outs in the European Union.

Simon Gleeson writes that while the UK does not have a blanket opt-out from EMU as a whole, it has a very specific opt-out from certain aspects of the euro project.



There was Economic Union before there was Monetary Union. The treaties provide for the European Commission to take a leading role in the formulation of economic policy. Perhaps surprisingly, the UK government signed up to an arrangement in which the Commission sets regular economic targets for the EU as a whole.

EMU became the fast-track to the euro with three stages. All member states of the Union, except for Denmark and the UK, are supposedly on a path to joining the euro. Those who are not currently members of the euro divide into the likes of Sweden and Poland – who have no immediate or medium term intentions to join – and south-eastern European members who are keen to make progress, but whose rapid accession to the euro area is likely to be opposed by Germany. At the moment there is therefore a fairly stable relationship between the euro-ins and the euro-outs.



Rubbings of euro coins. Photo: [Mika Meskanen](#) via a [CC 2.0 licence](#)

In 2010-2011 we saw the advent of “genuine” EMU. This had its roots in proposals from then-French President François Mitterrand and has been part of the French agenda in relation to EMU since its birth. It involves further European centralisation, including the notion that at least some sovereign debt should be raised centrally at the EU level and then lent outwards to member states. Even in those days it was clear that a centralised component of this was what was described as a completely integrated banking union.

Banking Union is often used as shorthand for a single supervision and cross border deposit guarantee scheme. For those who want further financial integration in Europe, banking union is an essential component.

“Genuine” EMU has now gone further to become “deep, genuine and fair.” It involves moving the European Stability Mechanism into the new treaty and a euro area treasury. Such a treasury would not just consist of a sovereign debt issuance capability but would be closer to the role of a real treasury with the capacity to actively manage debt. It also entails the convergence of key benchmarking standards such as on labour markets, competitiveness and the business environment.

Adhering countries are eligible for participation in the “economic shock absorption mechanism.” This is a transfer mechanism aimed at meeting periodic shocks, but not at permanent income-equalising transfers between countries. Countries could draw on this in the event of a downturn or shock to their economic business cycle. It also envisages increasing harmonisation of decision-making on national budgets and economic policies, including taxation and employment policies.

The EU’s attempts to create effective shock absorption mechanisms are in large part based on optimal currency area theories. The intention is to try and make Europe more like the United States, in the sense that if the government of California gets into trouble, there should be no impact on the economics of a bank based there. Whereas if the government of Greece gets into trouble, no matter how well a major Greek bank might be capitalised, it will still be in trouble. This is not a eurozone project; it is an EU-wide project.

The UK’s opt-outs

Under protocol 25 to the Treaty of the European Union, the UK has a number of opt-outs. Its powers in the field of monetary policy are not affected by the Treaty; it is not subject to the provisions of the Treaty relating to excessive deficits; and it is not concerned by the provisions of the Treaty relating to the European System of Central Banks (ESCB), the European Central Bank (ECB) or the regulations and decisions adopted by those institutions.

It is important to note that the UK therefore does not have a blanket opt-out from EMU as a whole. It has a very specific opt-out from certain aspects of the euro project. In theory and as far as a lot of European member states are concerned, Europe remains a single economic project. The perspective of the UK government at the moment is that there is a eurozone and a non-eurozone, they are different and have separate economic paths – this is in tension with European treaties.

The three pillars of the banking union

The banking union only applies to member states forming part of the eurozone. The banking union has three pillars. Under the first pillar, the ECB acts as central prudential supervisory authority for credit institutions located in the eurozone, through the Single Supervisory Mechanism, which is separated from the ECB’s monetary policy function.

There are 19 EU member states in the eurozone and the ECB supervises more globally systemically important banks than any other regulatory authority. Also, by assets supervised, it is the largest regulatory authority in the world.

The second pillar of the banking union is the Single Resolution Mechanism, with the Single Resolution Board located in Brussels acting as a central European resolution authority, mainly coordinating the measures of the national resolution authorities. Even more importantly, the Single Resolution Board is responsible for administering the Single Resolution Fund, a mutualisation of national resolution funds within the euro area.

The third pillar is the [European Deposit Insurance Scheme](#), the details of which will be proposed later this year. This is probably the most controversial part of the banking union, as a number of member states are currently opposed to the mutualisation of the national deposit guarantee schemes which are likely to be the most significant feature of this pillar.

Everything is based on the single rule book which is made up of directly applicable EU law and EU directives which need to be implemented by the member states. The London-based European Banking Authority (EBA) is in charge of the Single Rulebook aiming to provide a single set of harmonised prudential rules which institutions throughout the EU must respect. In particular, the EBA achieves this by issuing guidelines and by coordinating the answering questions from stakeholders on the practical implementation of the relevant EU regulation and directives. The Single Rulebook applies to the ECB as to any other prudential supervisory authority.

How the Single Supervisory Mechanism works

Under the [Single Supervisory Mechanism](#), the ECB directly supervises “significant” credit institutions, largely designated on the basis of their size and importance in the relevant member state. These consist of about 123 groups of credit institutions which in turn roughly consist of 1,200 individual institutions.

With respect to day-to-day supervision, the ECB is supported by the national competent authorities in the individual member states. These are largely the bank regulators that were in charge before the ECB took over. The less significant institutions, which number about 3,400 credit institutions, are only indirectly supervised by the ECB. That means that the national competent authorities are in charge but subject to any guidelines issued by the ECB.

It is important to note that under the Single Supervisory Mechanism the ECB is the only supervisory authority with the power to grant banking licences, irrespective of whether the institutions are significant or less so, and the ECB is also responsible for approving any acquisitions of qualifying holdings in eurozone credit institutions. However, the ECB has no jurisdiction – for example – in respect of payment services, markets and financial instruments and anti-money laundering.

The Single Supervisory Mechanism is interesting from a European law perspective because when acting under it, the ECB is one of the few European institutions which has direct administrative powers. Whilst the Single Supervisory Mechanism regulations provide a good basis for exercising these powers, a lot will ultimately need to be decided by the courts.

If a party is not happy with a decision of the ECB, there is an internal administrative review process at the Administrative Board of Review. If that fails, then any ECB decision can be brought before the European courts. This raises the question of what happens if a national competent authority has acted on the instructions of the ECB? Is this an ECB decision, or is this a decision which then can only be brought before the relevant member state’s courts?

Where the ECB is directly competent for supervising institutions, it will also apply national laws – ie directives which have been implemented in the relevant member state’s national laws. If a decision based on national law is brought before the European Courts, the question is whether a European Court can decide on matters of interpretation of national law.

With 19 participating states with different implementations of directives, it is very difficult to maintain a level playing field. That is one of the great concerns of the ECB. However, this is exactly the reason why the ECB has been put in charge of the Single Supervisory Mechanism. The ECB wants to reduce national discretions and options and together with the European Banking Authority build a more cohesive regulatory framework. In a recently published opinion, the ECB stated that it has a

“mandate to carry out prudential supervision with full regard for the unity and integrity of the internal market with a view to preventing regulatory arbitrage”.

This post is based on a talk that Simon Gleeson and Marc Benzler gave at Clifford Chance on 10 November 2015. It represents the views of the author and not those of the BrexitVote blog, nor the LSE.

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